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SBA

Business Basics

Risk Management and Insurance

A Self-Instructional Booklet
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GUIDESHEET

RISK MANAGEMENT AND INSURANCE

INTRODUCTION

This booklet is part of a series intended to help small businesspeople increase their knowledge of, and skills in, various aspects of business management. Other booklets in the series may be obtained from the nearest Small Business Administration field office.

Risk Management and Insurance looks at small business insurance needs. It covers the following topics:

- the purpose of risk management
- definitions and terminology
- liability coverage
- life and health insurance
- property insurance
- special coverages
- alternatives to commercial insurance
- buying insurance
- claims settlement

As a result of completing the booklet, the small businessperson should:

1. Be more aware of the risks that affect his or her business and know how these risks can be reduced.

2. Be better able to determine the types of insurance needed by that business, and the appropriate amounts.

3. Be more discerning in selecting an insurance agent.

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Ron Gompertz, the manager of a small clothing store, was pondering over the last bill he received from the insurance company. "These premiums are killing me. I must have insurance on everything under the sun, including my gold teeth. I have so many different policies that I wouldn't be surprised if some things were covered by two policies. There ought to be an easier way to get good insurance than this."

Linda Johnson, the owner of a small India import shop, seemed to have just the opposite problem. "Six months ago this store was broken into and burglarized and I am still trying to collect from my insurance company. They say my policy only covers robbery. Well, aren't they the same thing?"

Insurance is a complicated subject and few owners of small businesses understand it adequately. This booklet is intended to clarify some of the issues involved.

Some of the important questions this booklet covers are the following:

- What is risk management?
- What can be covered under an insurance policy?
- What are the benefits of having an insurance program?
- How much insurance does my business need?
- Is crime insurance available for high-risk areas?
- What alternatives do I have to buying insurance?
- How can I choose an agent or carrier for my risk management program?

OVERVIEW AND PURPOSE

This particular booklet should help you to:

1. Obtain greater awareness of the major risks that affect your business, and the types of insurance available to reduce such risks. The risks which will be discussed are:

    - o liability - your responsibility to compensate others for unfortunate occurrences to them and their property for which your business is considered responsible by the laws of the state
    - o property risk - the damages that can occur to your own possessions

2. Select an insurance agent, or carrier, and to determine the amount of insurance coverage you need.

3. Gain greater awareness of the alternatives which exist to buying insurance.

4. Increase your ability to obtain the settlement of claims to which you believe you are entitled.

FORMAT

The information in this booklet is presented in a unique way. For example, following each key thought will be a question or series of questions to which you will be asked to respond. These questions will require you to restate the key points described in the paragraphs immediately preceding the question. In each case, you should write a few notes on how you would respond to the question directly on the page in the space provided so you will have it as a permanent record for review. NO NEED TO WRITE COMPLETE SENTENCES - just a few words to indicate your thoughts. A good answer to each question will be given in the box on the first even numbered page which follows the question. Your answers need not match the booklet answers exactly.

It will, of course, do you little good to look ahead at the answers before writing out your own. The whole purpose of this type of learning format is to give you a chance to see whether you clearly understand and remember the information by writing it out before you check the answer.

In addition to the questions, you will be asked to work on several on-the-job activities. These will be brief suggested assignments which will give you a chance to apply one or several of the concepts discussed in the booklet to actual work situations in your own firm. If possible, you should discuss these assignments with someone whom you consider knowledgeable in insurance work, so you can benefit from any ideas which come up.

It is important to note here that this booklet is not intended to provide you with exhaustive information on this topic. Nor is it designed to tell you how to run your business. Rather, the booklet is intended only to increase your knowledge and skills by reviewing some basic practices that are appropriate for use in small firms. They can easily be modified to best serve the needs of your own firm.

RISK MANAGEMENT AND INSURANCE

Risk Management

Risk Management means identifying and controlling exposure of your business (or of your personal assets) to loss or injury. Since all businesses are exposed to hazards such as fire, theft, burglary, accidents to employees on the job, and injury to the public, and illness or even death of employees and owners, it makes sense to plan to control such risks.

Insurance is the best way to obtain such control and a good plan is one which consists of the following steps:

1. Identification of Risks
2. Evaluation of the chance of each risk occurring, the cost, should it occur, and the cost of insurance coverage.
3. Selection of the best way to handle each risk.
4. Control of each risk by implementing the best methods in an organized plan.

Let's examine each step a little further.

1. Identification of risks - means to explore your resources and services to discover possible threats of loss, damage, or expense to your business.

   How do you begin? Probably the best way to discover possible threats to your business is to conduct an organized search. You can begin by simply going through your financial and organizational papers:

   - the profit and loss statement
   - the balance sheet
   - schedules of employee hours, and
   - schedules of materials and equipment.

   At this identification stage, your only purpose is to answer the question, 'What if?' List everything that comes to mind. For example:

   - What if there were a fire? Could you afford to shut down? What would it cost to keep operating? Who pays?

- What if your employees are injured or go on strike?
- What if one of your products caused injury to the public?

2. Evaluation of the chance of occurrence and cost of each risk. Combine several risks that may happen at once, and re-evaluate the potential loss in dollars. What would a fire destroy? How much could burglars steal? Could you be sued? By whom? For how much? What would insurance cost?

3. Selection of the best way of handling the various risks. Some of the methods you could consider include:

   - Avoiding risk - by avoiding the situation which contains risk; for example, you can avoid risks to employees on hazardous tasks by hiring independent contractors to perform them.
   - Spreading risk - is often done by duplicating valuable records or documents so that in case one set is lost, you will have a copy.
   - Prevention of risk - this can take place through installing safety equipment, sprinkler systems, safety and quality control procedures, etc., and minimizing the potential of loss.
   - Transfer of risk - contracts can be entered with companies, (insurance companies) which will assume property, liability, fire, etc., losses. Such transfer of risk reduces potential of loss but requires the payment of a fee, called the premium.

4. Control of each risk. Try to make certain that none of the risks can occur and that all risks are covered by one or several of the methods discussed above.

Insurance

Insurance can be defined as a system of protection against loss in which an individual agrees to pay a specified sum (premium) for a guarantee that he or she will be compensated for a specified loss. In other words, the insurer promises to give protection (compensation) and service (aid) to the insured.

1. *What are the steps in a responsible risk management program?*

   Your Answer: (Remember, in this question, as well as in future ones, there is no need to write complete sentences - just key words on how you are answering the question. A good answer is on page 6.)

COMMON INSURANCE TERMS

Most insurance policies contain all or at least some of the following terms:

Coverage - the types of losses for which a policy will pay you. Most liability policies will pay for:

- The amount you become legally obligated to pay because of bodily injury or damage to property that you accidentally cause (including any immediate medical attention provided at the time of the accident).
- Expenses of settling any liability suit, whether the suit is justified or not.

Exclusions - the types of losses for which a policy will not pay. Most liability policies will not pay for obligations under workmen's compensation laws; damage to property of others which is in your care; or for liability resulting from blasting operations, from war, from the operation of state liquor laws, and from mishaps involving nuclear energy.

Limitations - the maximum amount of payment which a policy will provide for a loss. For example, the comprehensive general liability policy contains a limit per person and a limit per accident. A contract may specify that it will pay up to $100,000 per person injured or a total of $300,000 in any one accident. Other policies may have a single limit applying to both bodily injury and property damage. There is a total limitation on product liability that applies to any one batch of products. Thus a businessperson who carries a $25,000 policy on product liability may inadvertently be responsible for the sale of spoiled food resulting in 50 claims of $1,000 each. The policy treats this as a single 'accident' and will pay only $25,000, the limit of liability stated in the policy.

Book Answer

1. 1. *Identification of risks to your business.*

   2. *Evaluation of the potential of each risk occurring and the cost of insurance.*

   3. *Selection of the best method of handling each risk.*

   4. *Control of each risk by setting up an organized plan.*

Deductibles - the purpose of deductibles is to reduce premiums by permitting you to eliminate coverage for small losses and to carry the responsibility yourself. Deductibles are usually a specified dollar amount or percentage of loss, above which the insurance company will pay. For example, a $100 deductible collision insurance policy means that in the event you have a collision, you would have to pay the first $100 for repairs to your vehicle, and the insurance company would pay the balance. The premium for a $100 deductible policy might be $185 a year, while the premium for a $200 deductible policy might only be $140 a year. Thus, buying the $200 deductible policy, you would save $45 a year and give up $100 in collision coverage for each accident.

If you only have an accident about once every three years (or less), and you believe that this will be true in the future, it might well be worth your while to take out the $200 deductible policy because you will be ahead at least $35 every three years (savings = 3 x $45 = $135, cost in case of accident = $100).

Indemnity - is a principle which states that you can collect only the actual loss, and not an amount named in the policy as the policy limit. For example, if you take out $80,000 of flood insurance on a building worth only $50,000, you would not be able to collect $80,000 if the building was later totally destroyed by a flood. The indemnity principle prevents excessive insurance coverage, for profit, in high risk situations.

Actual loss is generally determined by an insurance adjuster who applies a reasonable allowance for depreciation against the current replacement cost of the lost property except when the policy specifies replacement cost.

2. *What do the terms Exclusions, Limitations, and Deductibles mean?*

   Your Answer:

TYPES OF INSURANCE

In this segment, the various types of insurance will be discussed briefly to help you review those that may be applicable to your business.

- o Liability insurance - for protection against injury or other damages that happen to other people and their property, for which the business may be legally responsible.
- o Life and Health insurance - to provide extra compensation to employees, owners and/or the business for losses sustained as a result of illness or death.
- o Property insurance - for protection against losses which may occur to your business' property.

LIABILITY INSURANCE

In conducting your business, you are subject to the laws governing negligence to customers, employees, and anyone else with whom you do business or who is on your property. Negligence may be defined as failure to exercise the degree of care required under the circumstances. For example, your firm is expected to maintain a safe place for people to enter. If someone falls on a slippery floor, you may be held liable (legally responsible) for damages even though you had posted signs warning of danger. In some cases, it can be shown that the injured person contributed to the loss by personal carelessness (called contributory negligence). Generally, however, when accidents occur on business premises, there is a strong presumption that negligence does exist.

Liability presents a major danger for your business since liability judgments can be very large. Liability judgments in the courts are, in fact, on the increase.

Book Answer

2. *<u>Exclusions</u> are the risks or losses which are not covered by the policy.*

   <u>Limitations</u> are the maximum amounts which an insurance company will pay for a single or multiple loss.

   <u>Deductibles</u> are the portions of the loss which you have to bear yourself.

Basically, there are two types of liabilities against which you have to insure yourself and your business: liabilities to non-members of the firm, and liabilities to members of the firm (employees and partners).

Liability to non-members of the firm includes:

- injuries to others while on your property
- injuries to others from the use of company automobiles, trucks and tools, engaged for business purposes, and which occur on or off the premises
- damage to other people's property - as in an automobile accident
- injury or damage as a result of the purchaser's use of a service or product of the company

Liability to members of the firm includes:

- compensation for work-related injuries, such as hospital, doctor bills, and payment for loss of salary (workmen's compensation). This form of compensation is required by law in all states.
- compensation for illness is more of a moral obligation than a legal matter, although some states do require businesses to take out disability insurance, to compensate employees for salaries lost while they are ill and unable to work. Covering hospital bills, doctor bills, and pharmaceutical expenses of employees is often done simply as a matter of good will to employees and sometimes to satisfy the terms of a labor agreement.

Most of the liabilities toward outsiders (non-members of the firm) may be covered under a general liability insurance policy, often referred to as a multi-risk policy, or comprehensive

liability policy. Some, however, are not included and have to be covered separately. The most prominent risks against which comprehensive general liability insurance does not protect you, are:

1. Liability as a result of an automobile accident by one of your employees while on the job.

2. Product liability.

3. Employer liability insurance covered under workmen's compensation laws.

It is, therefore, necessary for you to purchase separate liability protection against those potential liabilities which are not included in your general comprehensive policy.

3. *List four types of liability risks.*

Your Answer:

Automobile Liability Insurance

In most states, a business is required to maintain insurance on all automobiles or trucks that it operates. In addition, you can be legally liable for accidents by cars owned by others, such as employees or customers or sub-contractors who are involved in accidents while using their vehicles on behalf of your firm. This may even be true when your employees use rented or leased vehicles and, of course, applies when an employee is operating a car belonging to a customer.

Book Answer

3. Some types of liability risks which you may have listed:

- *injuries to non-members of the firm while on your property*
- *injuries to others from use of automobiles, trucks and tools, for business purposes, on or off the premises*
- *damage to other people's property as in an automobile accident*
- *personal injury or property damage as a result of the use of the service or product which the company provides*
- *compensation to employees or partners for work-related injuries*

Product Liability Insurance

Product liability insurance applies to manufacturers of products which cause injury or damage to product users. Although liability for harmful products is usually confined to the manufacturers of the product, sometimes the liability may extend to the retailer who sells the product as well.

Services too are a marketable commodity which can cause damage, and therefore may be subject to product liability. For example, an automobile repair shop which installs a muffler incorrectly could be liable for any injury to the passengers as a result of their breathing carbon monoxide caused by the muffler installation.

Workmen's Compensation Insurance

Workmen's compensation insurance is generally required by law and protects the employer against liability in the event of an accident. Under the law, employers are required to:

1. Provide employees with a safe place to work.
2. Hire competent employees (so they will not endanger each other).
3. Provide safe tools.
4. Warn employees of any existing dangers which may exist or develop on the job.

Under workmen's compensation insurance, an employee can collect payment for doctor bills and medications as well as hospital expenses and income payments for time lost beyond a specified minimum period. With regard to injuries which result in permanent damage, the individual can collect a lump sum payment to compensate for that loss.

In most states, compensation awards to employees are made on the basis of a hearing by an examiner or board, at which the employer has a right to be represented either directly, or jointly with the insurance company to assure that the liability of the employer is properly represented. For instance, awards may be smaller in case of contributory negligence by the employee, or when the loss is the result of an injury caused by a fellow employee.

Umbrella Policies

Once you have protection for the various areas where you are exposed to potential liability suits, you can purchase an overall insurance which covers large liabilities over and above your basic coverage, such as a million dollar law suit for the loss of a life in an accident. These general coverage umbrella policies are not expensive because the insurance company which provides it has to consider only the few claims which exceed the basic insurance coverage which usually is several hundred thousand dollars. Such policies can, however, protect you against high potential losses.

It is important that you read your policy carefully, especially the coverages and the exclusions so that you are aware what the policy covers and what it does not. Since there is a lot of fine print involved, you should take time to let your insurance agent explain it to you the first time you take out a policy. That will also help you decide on appropriate coverage.

It is also important to recognize that increasing the limits of your liability does not increase your premiums proportionately. Sometimes very large increases in liability insurance will bring only relatively small increases in premium because very few claims are in excess of the basic insurance level.

4. *List three types of losses which are usually not covered by general comprehensive liability insurance policies.*

   Your Answer:

5. *What does workmen's compensation insurance provide to injured employees?*

   Your Answer:

6. *What are 'umbrella' policies?*

   Your Answer:

LIFE AND HEALTH INSURANCE

Although not required by law to do so, most modern businesses carry life and health insurance for employees, in addition to workmen's compensation insurance in order to retain competent employees.

These life and health insurances include:

- basic life insurance
- basic health insurance
- major medical insurance
- specialty insurances, such as dental insurance or eye glass insurance

Life Insurance

The purpose of life insurance for employees is to provide financial protection to the employee's family, should the employee die. Certain group life insurance plans are tax-deductible for the employer. Group coverage can be attained at low rates even if there are ten or fewer employees in the group.

Life insurance is usually coupled with some form of basic health or major medical insurance.

Health Insurance

There are three major types of group health insurance plans:

1. Basic hospitalization and medical plans pay the cost of hospitalization, medical care and medication while hospitalized. Some also pay for some medical care outside of hospitals and for diagnostic services such as x-rays and blood tests. In some instances, the medical/surgical and the hospitalization plans may be on separate policies. This is typically the case with Blue Cross policies.

   Basic medical insurance is usually less expensive in group plans except in the case of very small groups. When a firm has only three or four employees who need coverage it may be less expensive to cover them with individual policies.

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Book Answer

4. *Three types of losses which are usually not covered by general comprehensive liability insurance policies are:*

   1. *Liability as a result of an automobile accident by one of your employees while on the job.*

   2. *Product liability - liability for products which cause injury or damage to product users.*

   3. *Employer liability insurance including workmen's compensation.*

Book Answer

5. *Workmen's compensation insurance provides the injured employee with payment to:*

   - *reimburse for all hospital and medical bills*
   - *buy medication*
   - *cover part of the lost income*
   - *compensate for permanent damage*

Book Answer

6. *Umbrella policies provide overall coverage for large liabilities over and above basic coverage - such as can be incurred when there is loss of a life in an accident.*

2. Major medical plans are designed to meet the costs of catastrophic illnesses and usually contain deductible clauses so that they apply only above the payments which basic medical and hospitalization plans are expected to cover. Major medical insurance plans are not very expensive, and are available today, even for very small groups. Such insurance is an excellent way to protect all employees against major medical expenses.

3. Disability plans are mandated in some states and pay employees a proportion of their salary during temporary or extended disabilities resulting from illness or from accidents that are not connected with work.

PENSIONS AND RETIREMENT PLANS

Many firms use life insurance annuities (regular payments) to provide pension benefits to their employees. These can be highly complex and can be very expensive. You should carefully investigate such plans in detail to be sure that you will not have rapidly increasing premium payments and that your business has ample income to afford such pension payments in the long run, before you decide to install a pension plan. Pension plans are subject to federal laws and IRS regulations. You should consult your accountant or lawyer to ensure that the plan you are considering will meet all requirements.

Furthermore, Individual Retirement Accounts (IRA) may sometimes have greater benefits for employees (as a result of tax deferment) than a small pension plan and a Keogh plan for self-employed owners may be more advantageous for you, if you qualify.

7. *Explain the difference between basic medical/hospitalization and major medical insurance.*

   Your Answer:

8. *What is the purpose of life insurance for employees?*

   Your Answer:

9. *What are disability plans intended to achieve?*

   Your Answer:

Book Answer

7. The difference between basic medical and major medical insurance is that basic medical and hospitalization plans pay the cost of routine hospitalization, medical care and medication while major medical plans are designed to meet the costs of catastrophic illnesses. Major medical usually contains deductible clauses so that it applies only above the payments which basic medical and hospitalization plans are expected to cover.

Book Answer

8. The purpose of life insurance for employees is to provide financial protection to an employee's family should the employee die.

Book Answer

9. Disability plans are intended to protect employees against the hardship of illness and accidents. Employees receive a proportion of their salary during disability resulting from accidents or illnesses that are not connected with work.

PROPERTY INSURANCE

Property insurance, often referred to as casualty insurance, insures your business against losses stemming from destruction of real property (buildings), and personal property (machines, furniture, finished goods, components, etc.).

Property insurance covers risks in three main areas:

1. Risks to property owned and used by the firm, such as buildings, materials, machinery, and finished products.

2. Risks to the product sold by the firm - particularly while in transit.

3. Miscellaneous risks such as robbery, business costs during the transition period after a disaster (business interruption insurance), or special losses such as destruction of a large item sold on credit, which your firm owns until it is fully paid for.

Protection against such risks includes the following insurances:

- fire insurance
- comprehensive property insurance (all-risk commercial property insurance)
- crime insurance for theft, burglary and/or robbery
- vandalism
- hail and windstorm insurance
- flood insurance
- automobile damage (collision) insurance
- inland marine insurance

Fire Insurance

The standard fire policy insures against three perils, or sources loss: fire, lightning, and losses to goods removed from your premises because of fire. The policy excludes theft and failure to protect the property after a fire. A special policy which extends beyond the standard fire policy is needed to cover the loss by fire of currency, securities, accounts, bills, deeds, and evidences of debt.

Extended Coverage

Most business firms supplement their basic fire insurance policy with extended coverage endorsements including such perils as theft and burglary, windstorm, hail, explosion, riot, aircraft damage, smoke damage, and vandalism. Sometimes all these are covered in policies called all-risk policies*. In addition, firms have to cover those risks which are usually excluded from such broad policies, such as vehicle damage (collision), flood damage, jewelry, manuscripts, and others).

All-Risk Commercial Property Insurance

The most common property insurance is the all-risk commercial property insurance policy. All-risk policies cover all perils except those specifically excluded by name. This has many advantages:

o You know that you are covered for all perils not specifically excluded and thus avoid the possibility of having any gaps in your coverage.

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*All-risk policies are sometimes also referred to as 'multiple peril' or 'multi-line' policies.

- o You are less likely to duplicate your coverage than if you purchase several different policies.

- o It is usually easier to obtain settlement for losses on an all-risk policy than it would be if you had several policies covering a single loss since there may be conflict as to how much each policy is to contribute to the loss.

- o The total premium on an all-risk policy is usually smaller than on the same coverage purchased separately.

All-risk property policies usually provide coverage up to a stated amount for losses in various major areas including:

- fire
- water damage (with the exception of floods)
- hail and windstorm damage
- theft and burglary
- vandalism

The special exclusions for which all-risk policies usually do not provide coverage include such items as: manuscripts, jewelry, cash, accounting records, securities, automobiles, steam boilers, machinery, and neon signs. It is therefore especially important to carefully read the policy to determine what the exclusions are and what the coverages are.

Damage to owned vehicles and boats usually also requires separate policies as does coverage for flooding and burglary, robbery, or theft and embezzlement by your employees.

Damage caused during riot or civil commotion is also usually excluded. However, if your business is in a high risk area, such as certain urban sections, you may be eligible for crime and riot insurance especially available from carriers who offer it in conjunction with support from the state and federal government.

The commercial property insurance policy can be written to include both:

- o Property other than inventory, wherever it is located - on your premises, in transit, or in a warehouse.

- o Varying levels of stock and inventory - such that your inventory is covered no matter what level you have in stock. Such coverage usually requires, however, that you file monthly reports with the insurance company on the value of goods you own so that a record of the actual inventory level will be available in the event stock is damaged or lost.

The commercial property insurance policy covers most retailers and wholesalers with all-risk protection on stocks of goods. When the all-risk property policy is written for a manufacturer it is called an 'industrial property insurance policy.'

Co-Insurance and Depreciated Value

One important feature of most fire and extended coverage policies is a co-insurance clause. Co-insurance requires the insured to carry a specified amount (percentage) of insurance based on the value of the insured property, or bear part of the loss. The required amount is usually 80% or 90% of the actual cash value of the property. This means that if you carry this much insurance relative to the actual value of the property, the insurance company will pay the total value of the loss. A significant reduction in policy premium results when a co-insurance clause is included.

An important thing to keep in mind is that coverage is often for only the depreciated value of the property lost. It is important to specify otherwise, if replacement value coverage is desired.

Crime Insurance

While burglary and theft can often be covered in the comprehensive 'all-risk' policies, various other crimes such as off-premise robberies, disappearance of money, employee theft, and embezzlement are not. These usually require either separate policies or comprehensive crime coverage. Reading the fine print, and/or working with a highly reliable and competent agent, is necessary to assure that the coverage is really appropriate for your business.

If employees handle large amounts of cash in your business, you may want to ask an insurance agent about fidelity bonds. Often referred to as "dishonesty insurance", fidelity bonds are written to cover losses caused by employee dishonesty, and, in some cases, losses due to crimes such as burglary and theft. Because of the rising incidence of employee theft and embezzlement, many businesses use fidelity bonds to protect against losses.

Vehicle Insurance

Just as automobile liability insurance is usually not covered in a general liability policy, so is damage to vehicles owned by the company generally excluded from all purpose property policies. A separate policy is therefore required unless the insurance company will provide a rider.

Inland Marine Floater Policies

Inland marine floater policies are special policies that are designed for the needs of specific types of business firms and for specific types of goods. Some of these are all-risk policies; others are named-peril contracts.

All-risk floater policies are generally available for jewelers, dry cleaners, furriers, and similar businesses not covered by the general all-risk commercial property insurance policy because their property is highly susceptible to loss.

Named-peril floaters are contracts which apply only to the perils specifically referred to within the policy. Such named-peril floaters are most frequently required by firms having exposure to loss because they own certain specific types of properties such as contractors' equipment which is frequently moved from place to place. Floaters may also be needed if you sell goods on credit or installment and therefore retain title to them until they are fully paid.

Named-peril contracts are also appropriate if you have exposed property which none of your insurance policies covers. Often an insurer will tailor a special policy or named-peril contract for you which will list the items you want insured.

10. *List six different types of property insurance policies.*

Your Answer:

11. *List the major exclusions commonly found in all-risk insurance policies.*

Your Answer:

12. *Explain the difference between commercial property insurance and inland marine floater policies.*

Your Answer:

13. *What are named-peril floaters used for?*

Your Answer:

Book Answer

10. Different types of property insurance policies include:

- fire insurance
- comprehensive property insurance
- inland marine insurance
- automobile damage (collision insurance)
- crime insurance for burglary and/or robbery
- hail and windstorm insurance
- flood insurance
- special policies for specific purposes

Book Answer

11. The major exclusions commonly found in all-risk insurance policies include: jewelry, cash, accounting records, securities, automobiles, steam boilers, machinery, and neon signs.

Book Answer

12. The difference between commercial property insurance and inland marine floater policies is that commercial property insurance usually covers a wide range of risks to personal property such as stocks of goods, fixtures, furniture, and improvements you make on a building as a tenant. On the other hand, inland marine floater policies are designed for the needs of specific types of business firms and cover specific types of goods.

Book Answer

13. Named-peril floaters are contracts which apply only to perils specifically referred to within a policy. Named-peril floaters are most frequently required by firms having exposure to loss because of owning certain specific types of properties such as contractors' equipment. Named-peril contracts are also appropriate to cover exposed property for which no particular insurance seems appropriate.

SUPPLEMENTARY AND SPECIAL PURPOSE COVERAGES

In addition to the basic property insurances which have been discussed so far there are supplementary coverages that some businesses need to protect against the potential of large losses. These include:

- transportation insurance
- business interruption insurance
- power plant insurance
- credit insurance

Transportation Insurance

An inland transit policy, the type most widely used by manufacturers for land shipments, covers those perils which are not the liability of a common carrier. Coverage includes collision, derailment, and "acts of God." Although pilferage is often excluded, theft of an entire shipping package can be covered.

A "released bill of lading", which makes the common carrier liable for only $50 worth of damage, can result in reduced transit rates, often enough to pay for the inland policy insurance.

Blanket motor cargo policies are similar to inland transit policies, but are policies written for truckers.

Business Interruption Insurance

When a business is shut down as a result of a major disaster, such as a serious fire or a flood, you may be protected for loss of property, but if you want to continue your business after the repairs have been made, you have to pay continuing expenses such as salaries of key employees, taxes, interest, etc., even though there is little or no income.

Business interruption insurance, an endorsement to a standard all-risk policy, can protect you against losses.

A business interruption policy can pay you for part of the profit and fixed expenses of your business. It usually has a high co-insurance requirement, and therefore will never cover the full amount. It can, however, be written to pay for a portion of your ordinary payroll over a limited period of time.

In deciding how much interruption insurance to purchase, you have to estimate how long it will take you to repair possible damage and get back into full operation.

Some business interruption policies provide special coverage, such as those for losses caused through the need to pay extra expenses for the rental of quarters or equipment, or for losses caused when an important supplier or customer's plant is damaged or destroyed by fire or other perils. The regular business interruption contracts would not cover such losses.

Power Plant Insurance

Boilers and other machinery or electrical equipment which can explode are usually not covered under all-risk property insurance, and therefore require separate policies.

Credit Insurance

Several types of credit insurance are in use by businesses. They include:

- credit life insurance
- commercial credit insurance
- installment sales floaters

Credit life insurance is generally used by retail firms selling goods on credit and insures the outstanding debt in the event of death of the customer. Credit life insurance is an inexpensive way to handle the risk of death among your debtors.

In a similar way, installment sales floaters protect you against loss which could occur when a purchaser has not insured goods bought on credit. Such a policy assures you payments for goods sold.

Commercial credit insurance is used to insure open account credit extended to buyers of merchandise for commercial purchases. It is not available to retailers and not all perils or losses are covered in full.

Commercial credit insurance offers a special kind of protection to firms that sell relatively large amounts and have only a few customers. It is the kind of insurance you would want if the failure of one of your customers to pay her or his bills when due would cause you serious financial hardship.

Special Insurance

Other insurance which a business could purchase if it considers them applicable include:

- Rent insurance - reimburses you for rent on property you lease if the tenant fails to pay.
- Profits and commission insurance - reimburses you for profits or commission you would lose if some peril destroyed the merchandise involved.
- Sprinkler leakage insurance - covers losses resulting from leakage from sprinklers.
- Glass insurance - insures expensive large glass surfaces such as plate glass windows and glass signs and showcases.
- Fidelity bonds - insures you against theft by employees.
- Key employee insurance - reimburses a firm for losses resulting from the death or total disability of an important employee on whom the business heavily depends. Similar insurance exists for business owners and partners. Under some plans, partners will take out insurance on each others' lives so that if one partner dies, any surviving partners can reorganize and pay the taxes, or find a new partner if necessary. Thus the business can continue and the beneficiaries of the deceased partner gain full, fair interest in the firm.

All these special insurance policies come in various types of forms and here too you would consult your agent to decide which form is most appropriate for your needs.

14. List some special purpose insurance coverages.

Your Answer:

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Book Answer

14. Some special purpose insurance coverages include:

- *transportation insurance*
- *business interruption insurance*
- *power plant insurance*
- *credit insurance*
- *sprinkler leakage insurance*
- *glass insurance*
- *fidelity bonds*
- *key employee insurance*

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15. What is co-insurance?

Your Answer:

16. What are the three types of credit insurance that you could purchase?

Your Answer:

17. What is business interruption insurance?

Your Answer:

18. What is key employee insurance?

Your Answer:

ALTERNATIVES TO COMMERCIAL INSURANCE

There are primarily three alternatives to purchasing insurance from an insurance company. These are:

- self-insurance
- transfer of the risk to a person other than the commercial insurance company
- loss prevention

Self-Insurance

Self-insurance means that your firm will assume the risk directly. Some people make a fine distinction between 'doing nothing about a possible loss against which insurance could be purchased', and 'self-insurance.' The distinction is that self-insurance refers to the setting aside of some funds that are roughly equivalent to the insurance premium, which would then be available in the event a loss actually did occur. Many small businesses cannot afford to set aside adequate funding and cannot predict yearly losses. Therefore, many small businesses cannot gain adequate protection through self-insurance.

Self-insurance is appropriate only if the risks are small enough so that the firm can afford the loss, if it should occur, without suffering serious damage. It is almost as fool-hardy to assume large risks when an expensive but reasonably priced commercial coverage is available. If your firm cannot afford the premium, it is certainly unlikely that you can afford the loss if it should occur.

Book Answer

15. *Co-insurance refers primarily to fire insurance and related lines where it requires you to carry a specified minimum amount (percentage) of insurance based on the value of the insured property, or bear part of the loss.*

Book Answer

16. *Three types of credit insurance that you could purchase include:*

- *Credit life insurance - usually used by retail firms selling goods on credit, to insure the outstanding debt in the event of death by debtor.*
- *Installment sales floaters - protect you against loss because a purchaser has not insured goods bought on credit.*
- *Commercial credit insurance - offers protection to firms that sell relatively large amounts and have only a few customers.*

Book Answer

17. *Business interruption insurance covers expenses of salaries to key employees, taxes and interest, should a business shut down as a result of a major disaster.*

Book Answer

18. *Key employee insurance is used to reimburse a firm for the losses that come from death or total disability of an important employee on whom the business heavily depends.*

Transfer of Risk

For practical purposes, there are not too many places where you can transfer your risks. You can do it by leasing automobiles, with the lessor maintaining the insurance, but that may involve higher costs than purchase and insurance. Purchasing services, rather than hiring people to do work, will also help reduce your insurance costs even though it may increase the cost of the work or project. If such hiring would be for limited periods during the year, however, purchasing services may be the more economical choice.

Loss Prevention

The purpose of considering alternative methods for assuming risk is to reduce the total cost. There are other ways that are sometimes available to reduce cost of insurance. In most high premium property coverages, such as fire and burglary, careful steps to reduce the risk of loss can have an impact on the premiums. With respect to fire insurance, moving and selecting locations where the premiums are lower, or installing sprinklers and alarm systems can help to reduce risk and premium. Carrying smaller inventory and complying with insurance company security requirements, or installing alarm systems can bring lower burglary insurance premiums because they help to reduce those risks.

19. What are the alternatives to buying commercial insurance?

Your Answer:

Book Answer

19. The alternatives to buying commercial insurance are:

- *Self-insurance - or assuming the risk directly. For smaller risks your firm may be able to set aside some funds that are roughly equivalent to the insurance premium. These would then be available in the event a loss actually did occur. Obviously, self-insurance is appropriate only where risks are small enough so that the firm can afford the loss if it should occur.*
- *Transfer of insurance through leasing or purchasing of services.*
- *Loss prevention - programs to reduce the potential of loss due to fire and theft, programs which often result in reduced insurance premiums.*

ON-THE-JOB ACTIVITY 1

1. Look over your insurance policies and review the risks for which you are covered. Where possible try to figure out the probability that such a risk would occur and what the cost of that risk would be to your business. From this information calculate the dollar value of the insurance and try to determine whether your firm would be better off self-insuring against such risks rather than paying premiums to an insurance firm.

2. Review your present policies to see where transfer of risk may be more economical than buying the insurance.

3. Explore with your insurance agent how improving the safety standards in your business and taking extra precautions against perils such as installing burglar alarms to help prevent burglaries, might affect your insurance premium.

If possible, discuss your thoughts with a person whose opinion you respect and see what additional ideas come from such a discussion.

BUYING INSURANCE

Buying the Right Amount of Insurance

In deciding whether you are buying the appropriate amount of insurance with the most advantageous amount of deductible, you might want to use a table such as the one shown below. Obviously, you will not always have several choices of coverage in order to stay within the co-insurance requirements, nor is every type of policy written with deductibles. In the hypothetical example below, comparisons are made between policies from the Great Insurance Company, and policies from the Top Insurance Company.

Table of Premiums

Insurance Company	Coverage	Deductible 500	1000	2000
Great Insurance Co.	60,000	1200	1000	600
	65,000	1260	1045	630
	70,000	1320	1100	660
Top Insurance Co.	60,000	1325	1100	650
	65,000	1380	1225	700
	70,000	1470	1300	750

The policies provide 60, 65, and $70,000 of coverage under three different levels of deductibles. The amounts in the boxes show the annual premiums that would be required for that coverage. In this example, the premium from the Great Insurance Company for a $60,000 policy, with a $500 deductible would be $1200 per year; with $1,000 deductible it would be $1000 a year; and with a $2000 deductible it would be $600 a year.

Now, suppose you have calculated that $60,000 of insurance is adequate coverage for your purposes because it satisfies a co-insurance requirement. Since the Great Insurance Company offers a better buy in all cases, you have already decided to do business with them.

What deductible should you buy ($500, $1000, or $2000) if you believe that a loss of $2,000 would occur less often than once every five years?

Here is how you can figure the answer:

> If you bought $500 deductible, you would probably pay $1200 a year for five years, or $6000 of premiums before a loss occurs which would cost you the $500 deductible. The net cost of the loss to you would then be $6000 in premiums paid plus the $500 deductible you paid against the loss, or $6500.
>
> If you bought $1000 deductible, you would pay $1000 a year for five years, or $5000 of premiums before a loss costing you $1000 (the deductible) occurs. The total cost of the loss would then amount to $5000 in premiums, plus $1000 deductible paid for the loss, or $6000.
>
> If you bought the $2000 deductible, you would pay $600 a year for five years or $3000 of premiums, before a loss costing you $2000 occurs. The net cost of the loss would then be the $3000 which you paid in premiums, plus $2000 deductible paid for the loss, or $5000.

Thus, if you are willing to self-insure for the difference between the $500 deductible and the $2000 deductible, you can possibly save as much as $1500 every five years.

Selection of the Insurance Agent or Carrier

Selecting an agent is of course of great importance in buying insurance. It helps to assure you that your coverage is complete, but not excessive, and also that you obtain help when a loss occurs and want to collect.

You should work only with an agent* who can advise on the type and the amount of coverage that is needed, who can provide suggestions with respect to the many specific details within a policy, and in whom you have confidence that you will not pay higher premiums than are necessary. Because agents are paid on a commission basis, they benefit personally from higher commissions. It therefore requires a person with considerable integrity to find the company or the policy which will give the best value. Such an agent is likely to consider service to customers important, will therefore check opportunities for reducing premiums and will search out those insurance companies which can give you the best overall coverage in relation to the premium. The insurance industry has found so many different ways to insure against different types of losses that you, as an individual, cannot possibly become aware of them all. A good

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*The term "agent" has been selected as a generic term to include agents, brokers, and direct writers in the following discussion.

agent should be able to advise you properly.

Insurance services are provided to the public in two major ways:

1. through independent agencies
2. by insurance companies writing directly through their own sales employees

Each type claims certain advantages for its customers.

Independent Agencies and Brokers

Those insurance companies who use agents give them representation rights in a given territory. Independent agents usually represent several companies and thus are usually able to offer a greater variety of coverage than a direct writer. An independent agent may also have greater incentive to serve a client who places all or most of the insurance business with the agent. Motivated by commissions and a desire to retain clients, an independent agent may pressure an insurer to provide better coverage and/or more rapid claims service for clients.

The distinction between agents and brokers is a vague one. An agent is a direct representative of a small number of insurance companies and can contract directly for these companies. The agent may have authority to issue policies from her or his office or change the written terms of contracts, though not all agents have this power. Some companies allow their independent agents to settle routine claims and thereby provide prompt claims service.

Brokers, on the other hand, do not represent insurance companies. Brokers represent their clients and place a client's business with that insurance company which can best serve her or his needs. They are not affiliated with the companies, however. The broker is thus able to "shop" among many companies for the best insurance value.

Direct Writing

When an insurance company maintains its own sales offices, the insurance services are distributed through direct writing. The direct writer, also known as a sales representative, can usually offer lower premiums than an independent agent. Because he or she works for only one insurer, the direct writer is usually fully knowledgeable in details of the full range of services offered by that company, can provide immediate answers and may have more time for giving complete service to the customer.

One method to convince yourself that you do indeed have a competent agent is to obtain quotations for your insurance coverage every three or four years from other agents. This will allow you to see to what extent other agents make suggestions that your present agent has failed to make, and to see the quality of the services these competitive agents are likely to render.

A brief summary of major points which have been discussed in this section can best be expressed in the form of a checklist for managing an insurance program. This checklist is provided on pages 35 and 36 in the form of questions that you may want to answer about your own program. The list is not complete, of course, and when you use it the first time, you may want to add some questions which are particularly applicable to your own business. In this way it will be more useful one or two years later, when you may again wish to review your insurance program.

20. *What are three techniques that you can use to assure that your are buying insurance well?*

    Your Answer:

CHECKLIST FOR ADEQUATE INSURANCE COVERAGE

1. Which of the following risks are applicable to my business and do I have coverage for them?

   a. Property Insurance:

   ___ Aircraft damage
   ___ Boiler and machinery
   ___ Civil commotion
   ___ Commercial property
   ___ Explosion
   ___ Fire
   ___ Flood
   ___ Hailstorm
   ___ Lightning
   ___ Riot
   ___ Riot attending a strike
   ___ Smoke damage
   ___ Theft
   ___ Vandalism
   ___ Vehicle damage
   ___ Water damage
   ___ Windstorm

   Floaters for

   ___ Business interruption
   ___ Credit
   ___ Dry cleaning
   ___ Furs
   ___ Glass
   ___ Gold
   ___ Installment sales
   ___ Jewelry
   ___ Neon signs
   ___ Rent
   ___ Sprinkler leakage
   ___ Transporation

b. Liability Insurance:

___ Automobile
___ General liability
___ Non-owned automobiles
___ Product
___ Umbrella coverage

c. Life and Health Insurance:

___ Basic health
___ Disability income
___ Group life
___ Key employee insurance
___ Major medical plan
___ Workmen's compensation

2. Adequacy in Coverage:

___ Check the adequacy of your coverage.

___ Compare coverage against co-insurance requirements, where applicable.

3. Reviewing Insurance Agent:

___ Check competitive bids on your policies.

___ Check for any instances where your agent may have neglected to suggest the best possible coverage.

___ Evaluate the effectiveness of your agent in gaining compensation for past losses.

___ Check with your agent for any potential problems relating to settlement of losses as a result of total insurance package.

___ Evaluate coverage on the most important exposures to ascertain if you are spending your insurance dollar wisely.

___ Evaluate use of deductibles.

___ Review where you can reduce premiums through assuming certain obligations through an improved burglary system or sprinkler system.

Book Answer

20. *Three techniques which you can use to assure yourself that you are buying insurance well are:*

    1. *For each type of insurance coverage, try to determine which deductible amount would be most appropriate for your own business and consider the possibilities of self-insurance. Here, again, a table containing the amount of insurance coverage, the different levels of deductibles, and the premiums to be paid, may be of help to you in making the right choice.*

    2. *Select an insurance agent carefully so that you have adequate coverage and you get help when you need it. Consider whether an agent, a broker, or a direct writer can best fulfill your insurance needs.*

    3. *Discuss specific insurance coverage and obtain quotations from several insurance agents every three or four years to find which one can provide the best coverage for the least premium. Setting up a table of the different insurance companies and the coverage and cost of the policies they provide is often helpful for this comparison.*

ON-THE-JOB ACTIVITY 2

1. Study the respective segments of the checklist for adequate insurance coverage (provided on pages 35 and 36). Run through that checklist and update the checklist where necessary to make it more suitable to your own business. Review your present policies against the checklist to make sure you have adequate coverage. If you find an area in which you may have inadequate coverage, you may wish to bring up the question with your present insurance agent or insurance company.

2. Use the checklist to review the service provided by your present agent and decide whether the agent is helping you to obtain the best and most economical coverage.

If possible, discuss your thoughts with a person whose opinion you respect and see what additional ideas come from such a discussion.

SETTLEMENT OF LOSSES

If you are covered by a reputable insurance company and represented by a competent agent, you will usually obtain fair and prompt settlement of your claim.

All policies do require you, however, to notify the insurer immediately upon the occurrence of a loss. This usually means as soon as possible.

In order to obtain a fair settlement, it is also necessary for you to provide the documentation that helps the insurance company determine the actual extent of your loss. Accurate accounting records can be very helpful. Records which are necessary to determine losses should be kept in a safe place where they will be protected againt fire, vandalism, or water damage.

In many lines of insurance the insurer has the right to choose whether to make a cash payment, to repair the damage, or to replace the damaged property with goods of like kind and quality, in a reasonable time.

Before an insurance company settles a claim, it uses an adjuster (often an independent firm specializing in evaluation of damage) to review the damage and determine a fair settlement.

Most insurance policies specify arbitration procedures if the insured and insurer cannot agree on the amount to be paid for the loss.

A few hindrances to settlement can occur. Most can be avoided if you keep them in mind when deciding on your insurance program. They are:

- Overlapping coverage - two or more policies insure the same property; this can delay settlement. Overlapping coverage is often difficult to prevent, such as an owner and a warehouser insuring the same property.

- Nonconcurrency - refers to differences among several policies covering the identical property. It is therefore desirable to cover any risk with one policy. If that should not be possible, care should be taken to see that the provisions for coverage are identical.

- Spreadout coverage - this means that you have given your insurance business to several local agents (usually in order to obtain the lowest premiums for each type of coverage). In such cases, no one agent or insurance company is completely responsible.

- Over-insurance or under-insurance - problems that can cause delays or hindrances to settlement. Some people believe that they can gain by under-insuring because damages are usually not equal to the total value of the property. This could turn out to be a mistake, especially when a co-insurance clause exists, since the insured cannot collect full value for partial loss when less than the specified percentage of the property's value is covered with insurance. Unnecessary premiums and overlapping coverage are the result of over-insuring.

- Inadequate records - when you cannot prove the extent of the losses, it may take time to agree on the amount and you may be reimbursed only for a part of your actual losses. These records, of course, should be kept in a safe place, such as a fire-proof filing cabinet, or away from your place of business.

21. *List the steps that you can take to help assure yourself that settlement of losses will be prompt, and without complications.*

Your Answer:

Book Answer

21. *Some steps that you can take to help assure yourself that settlement of losses will be prompt, and without complications are:*

- *notify the insurer immediately upon the occurrence of a loss*
- *keep a good set of records in a safe place where they will be protected against fire or other damage so that the actual extent of your loss can be documented*
- *avoid overlapping coverage of policies*
- *avoid noncurrence (taking out more than one policy on the same property in which the provisions for coverage are not identical)*
- *avoid spreading out coverage (giving your insurance business to several local agents rather than dealing with just one agent)*
- *do not over-insure or under-insure your property*

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